

CALIFORNIA LOTTERY

Report of Analysis

CALIFORNIA LOTTERY'S COMPLIANCE WITH ASSEMBLY BILL 142

For the Fiscal Year 2010-11



JOHN CHIANG
California State Controller

January 2012



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California State Controller

January 19, 2012

Members of the California State Legislature
State Capitol Building
Sacramento, CA 95814

Dear Senators and Assembly Members:

I am pleased to provide you with the State Controller's analysis of the California Lottery's compliance with Assembly Bill 142 for fiscal year (FY) 2010-11. Our review disclosed that Lottery net revenues allocated to public education increased during FY 2010-11 over prior fiscal years. Therefore, the Lottery complied with Government Code section 8880.4.5(c)(1) and (c)(2). As a result, sections 8880.4, 8880.63, and 8880.64 remain in effect, at least until the next analysis is performed for fiscal year 2011-12.

Questions regarding this report should be directed to John Hiber, Chief Operating Officer, State Controller's Office, at (916) 552-8080.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

cc: Robert T. O'Neill, Director
California Lottery
Michael T. Ota, Deputy Director
Finance Division, California Lottery
Roberto Zavala, Chief, Internal Audits
California Lottery

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Report of Analysis

Summary

In accordance with Government Code section 8880.4.5, amended by the enactment of Assembly Bill (AB) 142, the State Controller's Office (SCO) performed an analysis to determine whether the events described in Government Code section 8880.4.5(c)(1) and (c)(2) occurred and whether the Controller shall report to the Legislature regarding compliance with AB 142.

The SCO is required to report to the Legislature if the Lottery fails to comply with the provisions of AB 142, described in Government Code section 8880.4.5(c)(1) and (c)(2).

The SCO determined that the Lottery did comply with regulations, and, though not required to report, chose to provide the Legislature with the information obtained through our analysis.

Our determination that the Lottery complied with regulations is based on the following observations:

- The total net revenues allocated to the benefit of public education from the California State Lottery Education Fund (CSLEF) for FY 2010-11 totaled \$1,100,817,293. This amount was not less than the total net revenues allocated to the benefit of public education (\$1,002,527,893) in the last full fiscal year prior to enactment of AB 142 (FY 2008-09), excluding interest income or investment proceeds.
- The annual average of total net revenues allocated to the benefit of public education from the CSLEF was \$1,100,817,293, and was not less than the adjusted growth of Lottery revenues of \$1,096,956,325.

Lottery net revenues allocated to public education increased during FY 2010-11. Therefore, the events that are described in Government Code section 8880.4.5(c)(1) and (c)(2) did not occur. As a result, sections 8880.4, 8880.63, and 8880.64 are still in effect at least until the next analysis is performed for FY 2011-12.

Background

In 1984, California voters passed an initiative, which, by amending the State Constitution, authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to public education, and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

The SCO conducts quarterly analyses of the Lottery's transfer of funds to public education. These analyses are a part of the SCO's responsibility under the California Lottery Act (Lottery Act).

AB 142 amended the Lottery Act in April 2010. The Lottery Act now requires that not less than 87% of the total annual revenues be returned to the public. Of the 87%, not less than 50% of the total revenues, in an amount to be determined by the Lottery Commission, is to be returned to the public in the form of prizes. The Lottery Act also requires that not more than 13% of the total revenues be used for the Lottery administrative expenses. In addition, the Lottery Act requires the Lottery Commission to establish the percentage to be allocated to the benefit of public education at a level that maximizes the total net revenues allocated to public education.

Our prior analysis of the fourth-quarter transfer to public education disclosed that the Lottery complied with the annual statutory percentages for prizes, education, and administration for the year ended June 30, 2011. The Lottery returned 87.41% of the total revenues from the sales of tickets to the public for the quarter ended June 30, 2011. Of the 87.41%, 55.39% was returned to the public in the form of prizes, and 32.02% was transferred to public education. The Lottery Act requires the Lottery to return no less than 87% of the total annual revenues from the sales of Lottery tickets or shares to the public in the form of prizes and net revenues to benefit public education. The Lottery Commission determines the percentage of total annual revenues to be returned to the public in the form of prizes and to be transferred to public education. However, the percentage of total annual revenues for prizes must not be less than 50%. All other income and unclaimed prizes were transferred to public education.

FY 2010-11 is the first of five full fiscal years after the enactment of AB 142. To ensure that increases in Lottery net revenues are allocated to public education, the Lottery Act requires the SCO to determine whether both of the following events have occurred:

- The total net revenues allocated to the benefit of public education from the CSLEF are less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of AB 142.
- The annual average of total net revenues allocated to the benefit of public education from the CSLEF after the enactment of AB 142 is less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment AB 142, adjusted for an annual growth rate of 1.8% or the actual growth rate of Lottery revenues since enactment of AB 142, whichever is greater.

AB 363 further amended the amount of time the SCO has in which to prepare reports and convene a Lottery review group as required by AB 142. This bill requires the SCO to issue those reports by December 31 and March 31, respectively. The bill also extends the operation of the provisions described above until April 1 of the year following notification of the Legislature and the Governor by the SCO that the specified events have occurred.

Government Code section 8880.4.5. states:

- (a) Following the end of each full fiscal year, the commission shall calculate and report to the Controller and to the Legislature the amount of total net revenues allocated to the benefit of public education from the California State Lottery Education Fund for that fiscal year.
- (b) To ensure increases in lottery net revenues allocated to public education, if in any one of the first five full fiscal years after the enactment of the act adding this section, the Controller determines that both of the events described in paragraphs (1) and (2) of subdivision (c) occur, then the Controller shall notify the Legislature and the Governor, and post that notification on the Controller's Internet Web site, and on January 1 of the following year, both of the following shall occur:
 - (1) The amendments made to Sections 8880.4, 8880.63, and 8880.64 by the act adding this section shall become inoperative.
 - (2) Sections 8880.4, 8880.63, and 8880.64, as they existed prior to the effective date of the act adding this section shall become operative.
- (c) No later than December 31 following each of the first five fiscal years in which the amendments made by the act adding this section are in effect, the Controller shall report to the Legislature whether either of the following occurred in the prior fiscal year:
 - (1) The total net revenues allocated to the benefit of public education from the California State Lottery Education Fund are less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of the act adding this section.
 - (2) The annual average of total net revenues allocated to the benefit of public education from the California State Lottery Education Fund after the enactment of the act adding this section is less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of the act adding this section, adjusted for an annual growth rate of 1.8 percent or the actual growth rate of lottery revenues since enactment of the act adding this section, whichever is greater.
- (d) If the conditions specified in subdivision (c) do not occur, then in subsequent fiscal years, to ensure continued growth in lottery net revenues allocated to public education, the commission, when setting the percentage required in subparagraph (A) of paragraph (2) of subdivision (a) of Section 8880.4, shall ensure that net revenues allocated to public schools are at least as much as were allocated on average in the prior five fiscal years, and increased in proportion to any upward increases in lottery net revenues.
- (e) At the end of the first five full fiscal years following enactment of the act adding this section, the Controller shall convene a lottery review group to consist of the Controller, the Superintendent of Public Instruction, and the chairperson of the commission. The

review group shall report to the Legislature, no later than March 31 following the final fiscal year, on whether the amendments made by the act adding this section have furthered the purposes of the California State Lottery Act of 1984 as intended.

- (f) This section shall become inoperative on April 1 of the year following notification from the Controller to the Legislature and the Governor that the events described in paragraphs (1) and (2) of subdivision (c) have occurred, and as of the following January 1 is repealed, unless a later enacted statute, that is enacted before January 1 of that following year, deletes or extends the dates on which it becomes inoperative and is repealed.

Objectives, Scope, and Methodology

We performed an analysis of the funds transferred to the California State Lottery Education Fund for FY 2010-11 to determine if both of the following events occurred:

- The total net revenues allocated to the benefit of public education from the CSLEF are less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment AB 142.
- The annual average of total net revenues allocated to the benefit of public education from the CSLEF after the enactment of AB 142 is less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of AB 142, adjusted for an annual growth rate of 1.8% or the actual growth rate of Lottery revenues since enactment of AB 142, whichever is greater.

The scope of the analysis included, but was not limited to the following:

- Reviewing the amendments to the Lottery Act made by the enactment of AB 142.
- Reviewing the SCO's Reports of the Analysis of Quarterly Transfer of Funds to Public Education for the quarters ended June 30, 2009; June 30, 2010; and June 30, 2011; and corresponding working papers; and
- Performing an analysis to determine whether the events described in Government Code section 8880.4.5(c)(1) and (c)(2) occurred.

Results

After reviewing and performing an analysis of the total net revenues allocated to the benefit of public education from the CSLEF for FY 2010-11, we determined that Lottery net revenues allocated to public education increased during FY 2010-11 and that the Lottery complied with Government Code section 8880.4.5(c)(1) and (c)(2). As a result, sections 8880.4, 8880.63, and 8880.64 remain in effect at least until the next analysis is performed for FY 2011-12.

Government Code Section 8880.4.5(c)(1)

The Lottery was in compliance with Government Code section 8880.4.5(c)(1). Total net revenues allocated to benefit public education from the CSLEF for FY 2010-11 were \$1,100,817,293. This amount is not less than the total net revenues allocated to the benefit of public education for in the last full fiscal year prior to the enactment of AB 142 (FY 2008-09), which was \$1,002,527,893 excluding interest income and investment proceeds.

Government Code Section 8880.4.5(c)(2)

This section requires total net revenues allocated to benefit public education from the CSLEF for FY 2008-09 to be “adjusted for an annual growth rate of 1.8 percent, or the actual growth rate of the Lottery revenues since enactment of AB 142, whichever is greater.”

The adjusted total net revenue for annual growth rate of 1.8% for FY 2008-09 is \$1,020,573,395. The actual growth rate of Lottery revenues between FY 2009-10 (\$1,024,165,517) and FY 2010-11(\$1,100,817,293) was 7.48%, which is greater than the required 1.8%.

This section requires that the adjusted growth of Lottery revenues for FY 2008-09 be calculated by multiplying by 7.48% the adjusted annual growth rate amount for FY 2008-09 of \$1,020,573,395. The resulting amount is \$1,096,956,325.

FY 2010-11 is the first of the five full fiscal years being monitored subsequent to enactment of AB 142. Therefore, the annual average revenue is the same as revenues transferred to the CSLEF in FY 2010-11 (\$1,100,817,293).

The annual average of total net revenues allocated to the benefit of public education from the CSLEF was \$1,100,817,293, which was not less than the adjusted growth of Lottery revenues of \$1,096,956,325.

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